BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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In the Matter of the Application of San Gabriel Valley Water Company (U337W) for Authority to Increase Rates Charged for Water Service in its Fontana Water Company Division By $5,662,900 or 13.1% in July 2006, $3,072,500 or 6.3% in July 2007, and $2,196,000 or 4.2% in July 2008.	A. 05-08-021 (Filed August 5, 2005)
Order Instituting Investigation on the Commission's Own Motion into the Rates, Operations, Practices, Service, and Facilities of San Gabriel Valley Water Company (U337W).	I. 06-03-001. (Filed March 2, 2006)

RESPONSE OF THE DIVISION OF RATEPAYER ADVOCATES TO SAN GABRIEL VALLEY WATER COMPANY'S REHEARING APPLICATION OF DECISION 07-04-046

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Pursuant to Rule 16.1(d) of the Commission's Rules of Practice and Procedure, the Division of Ratepayer Advocates ("DRA") hereby respectfully submits its Response to San Gabriel Valley Water Company's Rehearing ("San Gabriel" or the "Company") Application of Decision ("D") 07-04-046.

San Gabriel cites three areas of D.07-04-046 that they assert demonstrate legal error: 1) Commission's allocation of contamination proceeds; 2) Commission's imposition of penalties against San Gabriel for Rule 1 violations; and 3) the Commission's forecast of San Gabriel's sales to California Steel Industries ("CSI") None of these issues, however, demonstrate legal error in the Decision. San Gabriel merely reargues the same points it has in its earlier briefs and comments.

I. THE COMMISSION DID NOT ERR IN ITS ALLOCATION OF THE CONTAMINATION PROCEEDS

A. Operation & Maintenance

San Gabriel argues that what should be included is the projected reimbursement of Operation and Maintenance ("O&M") costs for operating the treatment facilities as amounts ratepayers receive in condemnation proceeds. *See* San Gabriel Rehearing Application, p.6. The reimbursement for on-going O&M costs benefits, however the Company's shareholders as well because of the known and guaranteed recovery of future operating costs. The reimbursement is never a lump sum cash payment received through the proceeds, but is rather a reimbursement of current and future operating costs associated with the treatment facilities. Therefore, the Commission rightly did not factor it into determining the split of the lump sum condemnation payment.

B. Taxes

In determining the amount of net gain for contamination proceeds, DRA has not reflected an income tax offset. It is the Commission Policy to use flow-through accounting with the exception of federal accelerated depreciation and the California Corporate Franchise Tax. DRA has recommended flow-through accounting because there is no evidence in this proceeding that San Gabriel has in fact paid taxes. If the tax

offset were to be reflected, absent evidence that taxes have in fact been paid, a deferred income tax credit would be required to be reflected as an offset to rate base in addition to the net of tax Contribution In Aid of Construction ("CIAC") balance. As CIAC is amortized, it will impact income tax expense in that manner. Thus, ratepayers will pay the income tax impacts as the CIAC is amortized. *See* DRA Opening Brief, p.91.

San Gabriel, if they pay the tax on this gain, will not pay taxes until sometime well into the future. The impact of that payment should be reflected in rates in the future and thus there is no immediate need to reflect an income tax impact. Thus, the Commission did not err in not reflecting any tax consequences with the contamination proceeds.

C. Legal Expenses

San Gabriel argues that it has incurred legal expenses to obtain the contamination proceeds and that it never recovered that amount in rates because the Commission previously had not yet implemented the Water Quality Memorandum Account. *See* San Gabriel Rehearing Application, p.8-9. The Company argues that shareholders have funded the legal costs, not the ratepayers. This is entirely inaccurate because San Gabriel has included these legal costs in rates in prior cases based on a 10-year average of legal costs. In the current case, San Gabriel included these costs based on a 10-year average, excluding the perchlorate-related legal costs, which are tracked in a memorandum account.

The 10-year average, specifically includes all legal costs incurred prior to the memorandum account, including the contamination-related legal costs. San Gabriel's workpapers (p. 163-164), which DRA presented during the last day of hearings, clearly show that that the "Mid Valley Landfill" related legal costs incurred in 1997-1999 are included in deriving the 10-year average for legal costs. *See* Exhibit 84. Thus, these costs have already been factored in determining rates.

II. THE COMMISSION DID NOT ERR IN IMPOSING PENALTIES AGAINST SAN GABRIEL FOR ITS RULE 1 VIOLATIONS

A. San Gabriel misrepresents the facts and the condition of the record by asserting that the transaction was "fully disclosed and undisputed."

San Gabriel states its witnesses testified that the Company bought a 4.75 acre site for a new office complex from its affiliate, Rosemead, at a price based on a formal, independent appraisal by a licensed real estate appraiser. *See* San Gabriel Rehearing Application, p.22. The Company also argues that it discussed the transaction with DRA's consultants during it first GRC field visit and provided full documentation to them. *See id.* at 27.

San Gabriel, however, only disclosed to DRA's consultants that it had bought 4.75 acres for $1,102,000 at fair market value, but did not disclose that the 4.75 acres was part of Rosemead's initial purchase of 8.72 acres at $1,148,272 from a non-affiliated third party in 2003. *See* Exh. #45 & #48. Thus, San Gabriel did not fully disclose the facts associated with the purchase and then resale of the land to the regulated operations in its rate case application, A.05-08-021.

DRA's consultants had to issue a data request to San Gabriel and conduct its own thorough analysis to discover that San Gabriel only purchased "half" the original acreage Rosemead originally purchased for $1,148,272. Despite only purchasing "half" or 4.75 acres, San Gabriel still virtually paid the same amount Rosemead did in its original purchase. This was an excessive mark-up from the original cost of the land purchase by the real estate affiliate. *See* DRA Comments to Administrative Law Judge Barnett's Proposed Decision, p. 2.

Additionally, San Gabriel claims that attached to Mr. McGraw's prefiled testimony was a site plan layout, dated February 2, 2004 that expressly identified Rosemead Properties, Inc. as the owner of the Tokay Avenue property. *See* San Gabriel Rehearing Application, p.21. Buried in the site plan in small print is "Plan Identification" and under "F. Property Owner(s):," which identifies Rosemead with a PO Box address in El Monte,

California. This document did not identify Rosemead as an affiliated entity. Thus, San Gabriel was not forthright in fully disclosing the details of this affiliate transaction.

B. San Gabriel misrepresents the law by arguing that it did not violate any Commission rule or statute.

San Gabriel alleges that there is no specific affiliate transaction rule applicable to it, and therefore it has not violated any Commission rules or regulations in its affiliate transaction between Rosemead and San Gabriel. *See* San Gabriel Rehearing Application, p. 29-32. This argument is disingenuous and should be dismissed. The Commission has historically scrutinized transactions between regulated utilities and affiliated corporations and has in several cases imposed disallowances to account for excessive payments to unregulated affiliates. The Commission has the authority to review transactions between a utility and its affiliate to determine if it constitutes an arms-length transaction and whether ratepayers have been harmed.

Based on the facts presented in this case, the Decision correctly finds that ratepayers are harmed as a result of the Rosemead land sale to San Gabriel. Rosemead sold 4.75 acres of an 8.72 acre plot at nearly double the price it originally cost the affiliate. More troubling is San Gabriel's decision to hold the land for nearly two years before charging the regulated operations an inflated price instead of selling it when it was purchased. Thus, the Decision appropriately finds that the Rosemead transaction was not an arms-length agreement and that it was clearly self-dealing between Rosemead and San Gabriel.

The California Supreme Court has held that for ratemaking purposes, the Commission may disallow excessive and unreasonable payments between affiliated corporations. *See* Pacific Telephone and Telegraph Company v Public Utilities Commission (1965) 62 Cal 2d 634, 659. In addition, the Commission may disregard the separate corporate entities established around the regulated enterprise and may regard the operations of the separate entities and the operations of the corporate enterprise as a whole. *See* General Telephone of California v Public Utilities Commission (1983) 34 Cal 817, [*3]; City of Los Angeles v Public Utilities Commission (1972) 7 Cal 3rd 331, 344.

Thus, San Gabriel misinterprets the law by alleging the Commission lacks the authority to make such an adjustment simply because there is no specific affiliate rule applicable to San Gabriel.

Finally, the Commission can appropriately rely on basic ratemaking principles it has followed in evaluating affiliate transaction guidelines in other industries, such as telecommunications and energy. One of the basic premises in preventing inappropriate cross-subsidization between affiliates and monopoly operations is to require that transfers or sales from the affiliate to the utility to be priced at the lower of cost or market. The Rosemead sale has failed this basic ratemaking principle.

III. THE COMMISSION DID NOT ERR IN FORECASTING SAN GABRIEL'S SALES TO CSI

San Gabriel argues that the Decision incorrectly adopts DRA's forecast of San Gabriel's sales to CSI. *See* San Gabriel Rehearing Application, p.33. DRA rejected 50% of San Gabriel's proposed sales reduction to CSI. San Gabriel's projected reduction is based on its assumption that once CSI concludes its refurbishment of its wells, it will utilize its full 1,300 acre feet of water rights. *See* DRA Reply Brief, p.2.

DRA has always asserted that its CSI sales forecast is the most legitimate because San Gabriel has never provided any evidence into the record that CSI will fully utilize its 1,300 acre feet of water rights. *See id.* All that is included in the record is San Gabriel's testimony and a letter *from the Company* to CSI regarding the acre feet CSI will pump from its water rights. See Exh. #10. San Gabriel's assertion of CSI's intent comes purely from Mr. Michael McGraw's statements.

Nothing in the record includes actual information directly from CSI. After DRA contacted CSI, it could not verify with CSI the acre-feet it planned to pump. Thus, San Gabriel has not presented any outside evidence beyond its own statements that CSI will pump 1,300 acre feet of water per year. *See* DRA Opening Brief, p.7-8.

IV. CONCLUSION

DRA respectfully submits that the Commission should reject San Gabriel's Rehearing Application because it has not presented examples of legal error in regards to: 1) the Commission's allocation of contamination proceeds; 2) Commission's imposition of penalties; and 3) the Commission's forecast of San Gabriel's sales to CSI.

Respectfully submitted,

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May 31, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of **RESPONSE OF THE DIVISION OF RATEPAYER ADVOCATES TO SAN GABRIEL VALLY WATER COMPANY'S REHEARING APPLICATION OF DECISION 07-04-046** in**.A.05-08-021** and **I.06-03-001** by using the following service:

[X] **E-Mail Service:** sending the entire document as an attachment to an e-mail message to all known parties of record to this proceeding who provided electronic mail addresses.

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Executed on May 31, 2007 at San Francisco, California.

/s/ ANGELITA MARINDA
Angelita Marinda

N O T I C E

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A.05-08-021

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